



WELCOME TO
THE 2019 FRPA
CONFERENCE!

Internal Controls in a Parks and Recreation Agency



LEARNING OBJECTIVES

- Recognize the importance of implementing effective internal controls
- Identify risk and where it originates
- Understand best practices on different internal control related concepts



Internal Control

Committee of Sponsoring Organizations of the Treadway Commission

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) is a joint initiative of the following five private sector organizations and is dedicated to providing thought leadership through the development of frameworks and guidance on enterprise risk management, internal control and fraud deterrence:

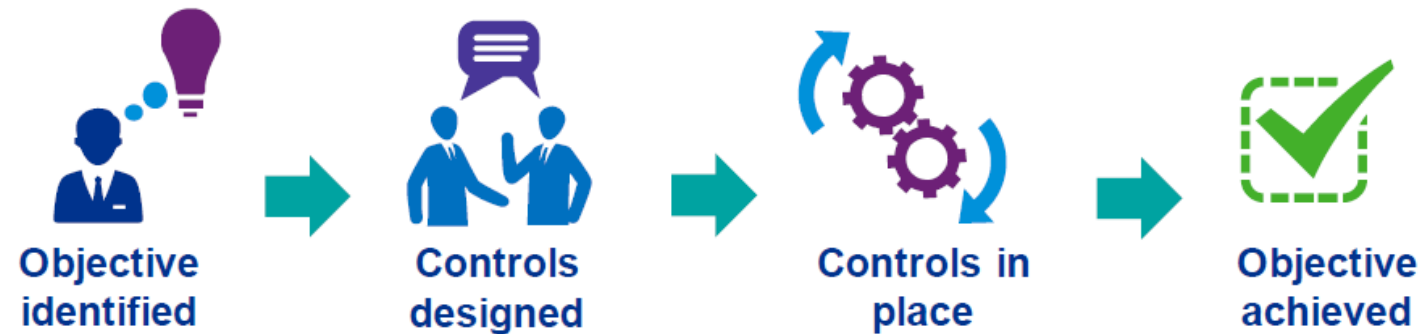
- AAA (American Accounting Association)
- AICPA (American Institute of Certified Public Accountants)
- FEI (Financial Executive International)
- IIA (Institute of Internal Auditors)
- IMA (Institute of Management Accountants)

U.S. Government Accountability Office

- The U.S. Government Accountability Office (GAO) is an independent, nonpartisan agency that works for Congress. Often called the "congressional watchdog," GAO examines how taxpayer dollars are spent and provides Congress and federal agencies with objective, reliable information to help the government save money and work more efficiently.
- On September 10, 2014, GAO issued its revision of *Standards for Internal Control in the Federal Government*, known as the "Green Book." This document sets the standards for an effective internal control system for federal agencies.

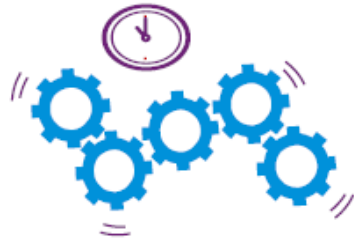
What is Internal Control?

Internal control is the integration of the activities, plans, attitudes, policies, and efforts of the people of an organization working together to provide reasonable assurance that the organization will achieve its objectives and mission.



How Does Internal Control Work?

Internal control helps an entity:



**Run its operations
efficiently and
effectively**



**Report reliable
information about
its operations**



**Comply with
applicable laws
and regulations**

Why do you need Internal Control?

- Reduce opportunities for fraud and waste
- Help management make better informed decisions
- Establish performance standards
- Eliminate adverse publicity
- Protect county assets
- Promote effectiveness and efficiency of operations
- Ensure reliability of financial reporting
- Promote transparency and accountability
- Helps ensure compliance with applicable laws, regulations, policies, and procedures



Internal Control Example

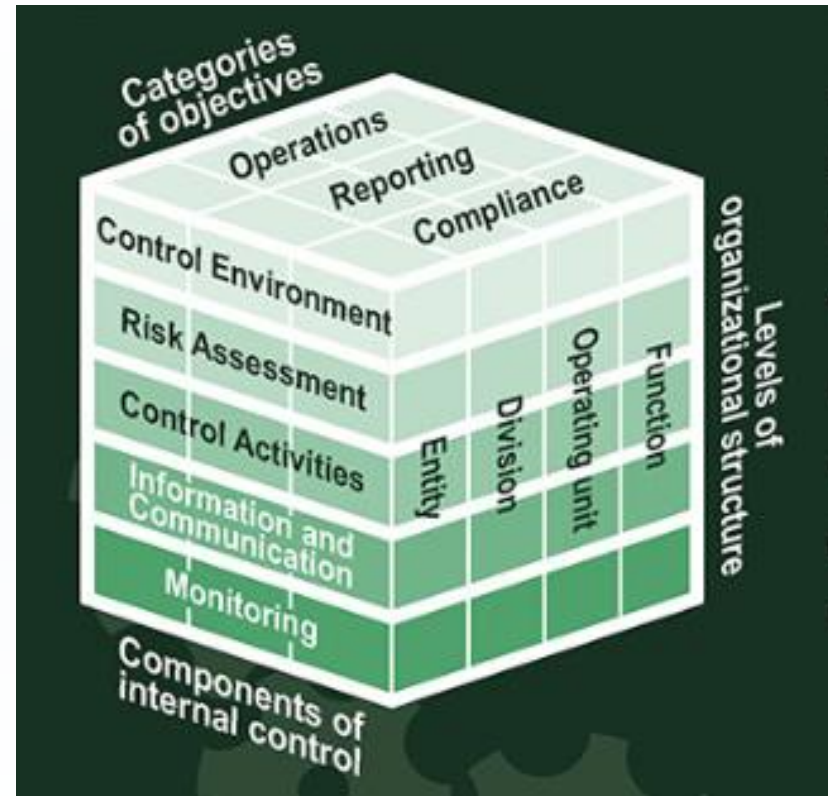
You exercise internal control principles when you:

- Lock-up valuable belongings
- Keep copies of your receipts
- Review your paycheck
- Make travel plans



Five Components of Internal Control System

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring



COSO Internal Control Integrated Framework Principles

Control Environment

- 1. Demonstrate Commitment to Integrity and Ethical values
- 2. Exercise Oversight Responsibility
- 3. Establish Structure, Responsibility, and Authority
- 4. Demonstrate Commitment to Competence
- 5. Enforce Accountability

Risk Assessment

- 6. Define Objectives and Risk Tolerances
- 7. Identify, Analyze, and Respond to Risk
- 8. Assess Fraud Risk
- 9. Analyze and Respond to Change

Control Activities

- 10. Design control activities
- 11. Design Activities for the Information System
- 12. Implement Control Activities

Information & Communication

- 13. Use Quality Information
- 14. Communicate Internally
- 15. Communicate Externally

Monitoring

- 16. Perform monitoring activities
- 17. Remediate Deficiencies

Control Environment

- Management's attitudes, awareness, and actions concerning the importance of its internal control functions. The control environment sets the tone of the organization, influencing the control consciousness of all its employees.
- Serves as the foundation for all other standards of internal control
- Effective organizations set a positive "tone at the top"
- Factors that influence an entity's control environment are:
 - management's philosophy and operating style
 - the way in which management assigns authority and responsibility;
 - the way management organizes and develops employees;
 - and the attention and direction provided by the governing board.

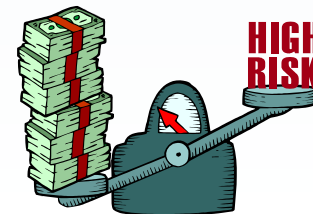


Control Environment Examples

- Set “tone at the top” by implementing and promoting ethical standards, integrity, and accountability policies
- Set mission, goals and objectives (strategic planning) so the organization knows what it is to accomplish
- Establish structure, organizational responsibilities, and reporting chains
- Hire competent and trustworthy staff members and provide necessary training for them
- Provide leadership and good governance by staying on top of operations and performance, and correcting problems when identified
- Emphasize that compliance with laws and regulations is the expectation for the organization
- Assure that goals and objectives are clear and not in competition with each other or compliance requirements
- Hold people accountable for their responsibilities.

Risk Assessment

- The identification of factors or conditions that threaten the achievement of an organization's objectives and goals.
- Risks are internal & external events (economic conditions, staffing changes, new systems, regulatory changes, natural disasters, etc.) that threaten the accomplishment of objectives.
- Risk assessment is the process of identifying, evaluating, and deciding how to manage these events
 - What is the likelihood of the event occurring?
 - What would be the impact if it were to occur?
 - What can we do to prevent or reduce the risk?



Why is a Risk Assessment Important?



- A risk assessment will help you:
 - Create awareness of hazards and risk.
 - Identify who may be at risk (e.g., employees, cleaners, visitors, contractors, the public, etc.).
 - Determine whether a control program is required for a particular hazard.
 - Determine if existing control measures are adequate or if more should be done.
 - Prevent injuries or illnesses, especially when done at the design or planning stage.
 - Prioritize hazards and control measures.
 - Meet legal requirements where applicable.

Risk Assessment Questions

- What are our primary objectives?
- What must go right for us to succeed?
- What could go wrong?
- What events or conditions can prevent us from achieving these objectives?
- What assets do we need to protect?
- What information do we rely on to achieve our objectives? What are the threats to our obtaining this information?



Risk Assessment Questions

- What typical decisions are made in our operations? Which of these decisions require the most judgments?
- What are our most complex activities?
- What potential legal liabilities can result from our operations?
- Where do we spend most of our money?
- What changes do we see on the horizon?
- How could someone steal from the organization?
- How could someone disrupt our operations?

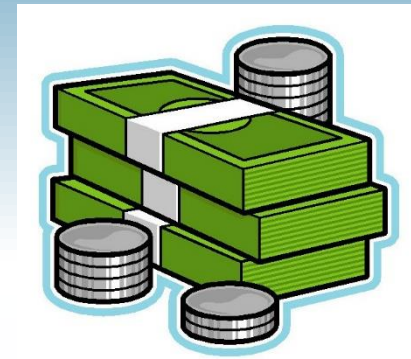
Control Activities

- The policies and procedures designed by management to help ensure that the organization's objectives and goals are not negatively impacted by internal or external risks.
- Help prevent or reduce the risks that can impede the accomplishment of objectives.
- Occur throughout the organization, at all levels, and in all functions.
- Should be designed to limit the potential negative effects of risks identified during the assessment process
- Includes approvals, authorizations, verifications, reconciliations, security of assets, reviews of operating performance, and segregation of duties.

5 Key Internal Control Activities

1. Segregation of Duties
2. Access Controls
3. Authorization Control
4. Supervisory Oversight
5. Education/Awareness





Revenue Control Policy

- Cash receipting and accounts receivables should be subject to proper internal controls including:
 - Segregation of duties such as initiation and authorization of transactions, execution of transactions (receipting and disbursement), recording transactions, reconciliation, and maintaining custody.
 - Daily processing and timely deposit of receipts. Ideally, all funds should be deposited within 24 hours of receipt.
 - Timely reconciliation to applicable ledgers.
 - Physical security procedures. This is especially important for funds not deposited day of receipt.
 - Fraud reporting procedures.
 - Use of integrated receipt and accounting systems wherever practical and cost-effective.

Compensating Controls



- If duties cannot be segregated due to limited resources compensating controls must be put in place
- In cases where duties cannot be effectively separated, management can substitute increased review or supervision as an alternative control activity that can help prevent or reduce the risks.
- In an environment with a very limited number of employees, management needs to be involved in documenting, reviewing, and approving transactions, reports, and reconciliations.

Control Activities Scenario

What can be done to segregate duties in the following scenarios? If duties can't be segregated what compensating controls can be put in place?

1. John is Manager at the Campground. John takes the reservations, processes payments, and makes the deposits.
2. Jane is a playground safety inspector. She performs all of the playground inspections, maintains the playground equipment, process the purchase orders for new and replacement parts, and performs the annual playground inventory.

Information & Communication



- Pertinent information must be captured, identified and communicated on a timely basis.
- Effective information and communication systems enable the organization's people to exchange the information needed to conduct, manage, and control its operations.
- Management must be able to obtain reliable information to determine and assess risk and communicate policies and other information

Information & Communication

- Establish relevant and reliable information systems to track operations, goal progress, and compliance;
- Broadly distribute information throughout the organization to ensure that critical information is delivered to the right staff in a timely way.
- Establish separate lines of communication, such as fraud and ethics hotlines, for confidential information. Inform employees of these separate reporting lines, how they operate, and how reports are handled;
- Establish both outgoing and incoming lines of communication with external entities.
- Stay aware of external events that could pose a risk.

Monitoring

- Determines whether or not policies and procedures designed and implemented by management are being conducted effectively by employees.
- Helps ensure that significant control deficiencies are identified timely and rectified.
- Monitoring helps to identify these new risks and the need for new control procedures
 - Have controls become outdated, redundant, or obsolete?
- Monitoring occurs in the course of everyday operations, it includes regular management & supervisory activities and other actions personnel take in performing their duties.



Monitoring

- Establish a system of quality control over all processes such as supervisory reviews, approvals, and automated exception checks;
- Conduct routine reviews of actual performance compared to goals and budgets;
- Conduct separate management reviews of a function to determine whether it is working as intended, or controls need to be redesigned.
- Arrange for external audits and be responsive to findings;
- Track all corrective actions, and ensure that they are implemented and working as intended;
- Use monitoring to tie corrective actions back to improvements in Control Environment and Control Activity standards;
- Watch for signs of control problems.

Limitations on Internal Control

- No internal control framework can be 100% fraud proof
- Limitations include:
 - Management over-ride of controls (policies and procedures)
 - Collusion
 - Cost vs Benefit
 - Cost of the control should not cost more than the benefit it is expected to achieve
 - Human error
 - Inability to segregate duties based on number of employees (compensating controls)

Questions ???



Fraud

Fraud Triangle



How Does Fraud Occur?

- Poor internal controls
 - Lack of proper authorization
 - No separation of authorization, custody, record keeping
 - No independent checks on performance
 - Lack of clear lines of authority
 - Inadequate documentation
- Management override of internal controls
- Collusion between employees and management
- Poor or non-existent ethics policy
- Limited, unclear or no policies and procedures to direct department/division processes



Red Flags of Fraud

- Borrowing money from co-workers
- Creditors or collectors appearing at the workplace
- Gambling beyond the ability to stand the loss
- Excessive drinking or other personal habits
- Easily annoyed at reasonable questioning
- Providing unreasonable responses to questions
- Refusing vacations or promotions for fear of detection
- Bragging about significant new purchases
- Carrying unusually large sums of money
- Rewriting records under the guise of neatness in presentation



Red Flags of Fraud

- High personnel turnover
- Low employee morale
- No supporting documentation for adjusting entries
- Incomplete or untimely bank reconciliations
- Increased customer complaints
- Write-offs of inventory shortages with no attempt to determine the cause
- Unrealistic performance expectation
- Rumors of conflicts of interest
- Using duplicate invoices to pay vendors
- Frequent use of sole-source procurement contracts



Examples of Internal Control System Failure

Scenario #1

A member of the public asked if the annual boat trailer permits could be sold as daily permits. Without a mechanism to sell them on site, the Department installed an “honor box.” The public dropped the \$10 cash fee in the honor box and took a tag to put on their re-view mirror. The Park Rangers picked up the locked honor box (only Admin staff had the key) and delivered it to the Administrative offices for processing. Sally was always the first one to volunteer to empty the honor box and create the deposit. What happened?

Scenario #1/Internal Control Mistakes

- As soon as the cash was delivered two staff people should have counted the funds. An initial counter and the verifier.
- After the cash count, the cash should have been placed into a drop safe
- At the end of the day the manager should have prepared the deposit

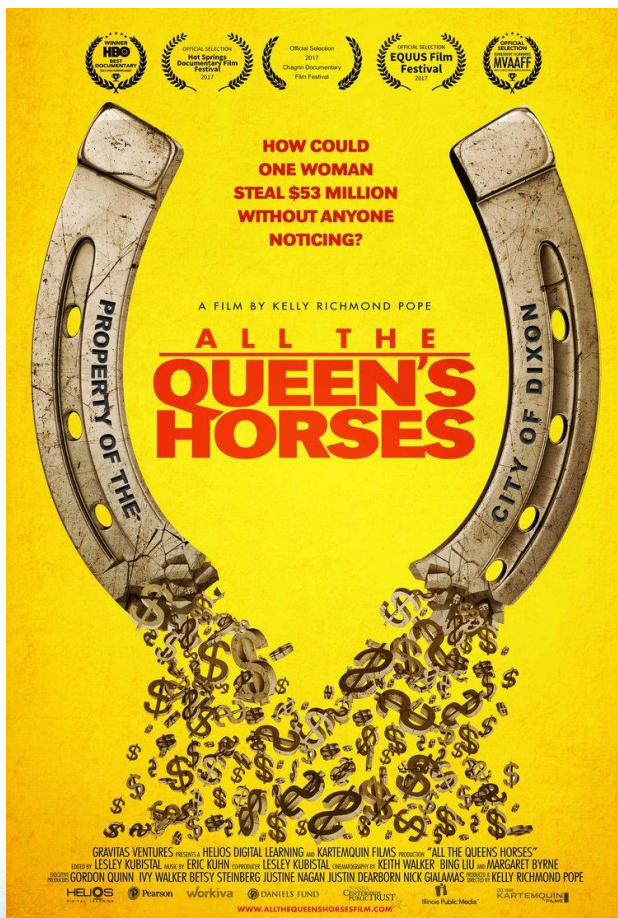
Scenario #2

Amy was in charge of three recreation centers. Each recreation center had a manager and multiple non-permanent employees. Each manager submitted their completed payroll/timesheets (paper records) to Amy for review. Amy approved and submitted all of the payroll/timesheets sheets to payroll for processing. Amy requested that she personally receive the checks (direct deposit didn't exist) for the employees so she could hand them out to the staff at the recreation centers. What happened?

Scenario #2/Red Flags

- Inconsistent overtime hours for cost center
- Large or unusual hours worked in a given pay period
- Reported hours differ from time card hours
- Terminated employee still on payroll
- Unauthorized alterations to time cards and other source records
- Hours and dollars consistently at or near budgeted amounts
- Timecards are filled out by supervisors not by employees

All the Queen's Horses



Link to Video: <https://youtu.be/q57ZKn-C-To>

Scenario #3

- Rita Crundwell, City Treasurer Dixon, Illinois stole \$53,000,000 (Ranked the largest municipal fraud and 5th largest fraud of any kind in U.S. history)
- Dixon Illinois, Population less than 16,000
- Annual operating budget around \$8,000,000
- Governed by part-time mayor and four commissioners
- Rita's annual salary was \$80,000
- City was audited annually by CPA firm, clean audits with no instances of noncompliance.

Scenario #3/How did this happen?

- Rita was a trusted employee and there was no segregation of duties over keeping the accounting records and disbursing funds.
- She opened a separate bank account under the city's name called the "Reserve Sewer Development Construction Account"
- She wrote checks from the Capital Development Fund to the Treasurer. She then deposited those funds into the Reserve Sewer Fund.
- She was only authorized check signer for account, she alone reviewed/reconciled all city bank statements and the side bank account was not recorded on city general ledger.

Scenario #3/How did this happen?

- Rita created 179 fictitious construction invoices from IDOT and disbursed funds from regular city accounts to the side bank account.
- She would then draw funds from the side account for personal use.
- The CPA firm that did the city's audit had been the city's auditor for over 20 years.
- The auditors had also been doing Rita's personal tax returns for over 20 years on the side.

Scenario #3/How was she discovered?

- In the fall of 2011, Rita took an extended vacation.
- A city clerk employee responsible for overseeing the city finances while Rita was gone requested all of the bank statements.
- In October of 2011 the city clerk discovered the Reserve Sewer Account and notified the mayor who in turn contacted the FBI.
- The FBI conducted their own investigation and Rita was arrested on April 17 2012.ß

Scenario #3/Outcome

- Total Embezzlement: \$53,000,000.
- CPA firms agreed to a payment of \$36,150,000 in lawsuit settlement with city. Auditors released statement taking a share of the responsibility for the fact that the fraud was not detected.
- The city's bank settled in lawsuit for \$3.85 million.
- U.S. Marshall Service seized Rita's property and assets and sold for around \$10,000,000.
- The City incurred \$10,000,000 in legal fees.
- In the end, the City still lost \$13,000,000 from the fraud.

Scenario #3/Internal Controls

- City of Dixon switched from multiple bank accounts to a single account
- Paper checks are no longer allowed
- Segregation of duties was put in place with installation by a City Administrator and a Finance Director.
- State of IL passed into law a requirement that annual audited financial statements be presented to each member of city council or county board in a public meeting and posted on a public website.

In Summary

- Understand the Five Components of Internal Control
- Use the 17 principals to determine if your internal control system is effective.
- Make sure you have up-to-date policies and procedures
- Ensure authorization limits are communicated within your department
- Ensure all assets (especially cash) are safeguarded at all times
- Ensure approval signatures are visible (legible) on all required documentation
- Make sure data is **only** accessible by authorized personnel
- Understand your department/function's risks

References

- *Standards for Internal Control in the Federal Government*, known as the "Green Book," sets the standards for an effective internal control system for federal agencies.
 - <http://www.gao.gov/greenbook/overview>
- COSO's *Internal Control –Integrated Framework* for a government environment.
- Association of Government Accountants
 - <https://www.agacgfm.org/About.aspx>
- Government Finance Officers Association
 - <https://www.gfoa.org>

Questions ???



PALM BEACH COUNTY



PARKS & RECREATION

National Gold Medal Award Winner



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FOR MORE INFORMATION ABOUT THE FLORIDA RECREATION AND PARK ASSOCIATION VISIT FRPA.ORG